# A Critique of Pension Reform Act, 2004 in Nigeria

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**ABSTRACT**

Pension is benefit paid to an employee after attaining the statutory required age of retirement or if the employee leaves employment for other reasons. The benefit is meant to guarantee comfortable life after active years of service and also assist in the maintenance of living standard previously enjoyed during the beneficiaries' active productive years. However, previous attempts by successive governments in Nigeria at instituting a hitch-free workable Pension Scheme have been hampered by inadequate and untimely funding, improper records, endemic fraud and corruption leading to avoidable pains and misery for the retirees and beneficiaries. It was on the account of these challenges in pension administration that the government of the Federal Republic of Nigeria, as part of its reform agenda established a new scheme referred to as Pension Reform Act, 2004. The study based on the qualitative research method and employing review of relevant literature takes a critical examination of the Act and concedes that although some inherent defects exist in the operations of the new Pension Scheme, these pitfalls are not fundamental or substantial to compromise or undermine the overall objectives of the Act. The paper therefore calls for an urgent review of some portions of the Pension Act, to check fraud, corruption and abuses currently inherent in the system. To treat these shortcomings with levity the paper contends may be tantamount to the State not playing its dutiful role in taking care of its senior citizens after active and meritorious years of service to the nation and fatherland.

## 1. Introduction

Pension is benefit paid to an employee on retirement or after attaining the statutory required age. It makes employee financially independent at old age and during the post-employment period. It represents a reward for long duration of service and loyalty to an employer and it could be perceived as a deferred remuneration package. It could guarantee comfortable life after active years of service and also maintenance of living standard previously enjoyed during active productive years.

Before the advent of the Pension Reform Act, 2004 in Nigeria, the public sector operated the Defined Benefits (DB) - Pay As You Go (PAYG) schemes that rests for funding heavily on statutory budgetary provision from various tiers of government. However, the schemes could not be sustained due to inadequate and untimely release of fund at appropriate time by government, records were not properly kept, endemic fraud and corruption, infliction of avoidable pains and misery on retirees amongst others.

The government of the Federal Republic of Nigeria, as part of its reform agenda established a new scheme referred to as Pension Reform Act, 2004. Some of its features include that of being mandatory for employers and employees of the Federal Public Service, the Federal Capital Territory and the Private Sector of the economy. The primary aim of the new scheme is to enable retirees meet the challenges of retirement. And to ensure the smooth functioning of the scheme in terms of regulation, administration and management, the government established a body known as the National Pension Commission (PENCOM) to administer the scheme. The objectives of the new pension reform are to ensure that every worker receives his retirement benefits as and when due, empower the worker, assist workers to save in order to cater for their livelihood during old age, establish uniform rules, regulations and standards for administration of pension matters and

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establish strong regulatory and supervisory framework for the Scheme (Pension Reform Act, 2004).

The Scheme is fully funded, i.e. pension funds and assets are provided to match pension liabilities, in other words, money is contributed into individual employee's Retirement Savings Account (RSA) and when he/she retires, there will be money in his/her RSA to pay his/her pension. It operates on individual accounts. Each employee opens RSA with any licensed Pension Fund Administrator (PFA) of his/her choice. It is privately managed. The employer pays directly to the Pension Fund Custodian (PFC) the total contributions, which will be managed and invested by the PFA of the employee's choice. The Scheme is strictly regulated and supervised by PENCOM, which is empowered to do so by the Pension Reform Act 2004.

The Scheme is contributory, meaning that the employer and the employee contribute into the fund, each contributing a minimum of 7.5% of the employee's monthly emoluments (comprising monthly basic salary, transport and housing allowances) in the case of the public service and the Federal Capital Territory (FCT) and the private sector. In the case of the military, the employer (Government) contributes 12.5%, while the employee contributes 2.5%. This makes a total of 15%. Employees in the State and Local Government services are not covered by the scheme.

## 2. Literature Review

According to Njuguma (2010) authors like Curtler and Johnson (2004), Guinan (2003), Langley (2006) and Newmann (2005) eulogized the role of the German Chancellor, Otto Von Bismarck played in enacting a compulsory savings programme for workers in large firms who were exposed to the socialism ideologies in 1889. In Nigeria, the development of Pension Scheme can be traced to the period of organized workforce in the private and public sectors in the colonial era of the 20th century (Barrow, 2008). To corroborate the foregoing fact on the history of pension system in Nigeria, Balogun (2006) states that it dates back to year 1951 when the first pension Scheme was inaugurated in the country. Besides Nigeria's first ever legislative instrument on Pension matters was the Pension Ordinance of 1951 which had a retroactive effect from 1st January, 1946. The legislation provided pension and gratuity for public sector employees while the National Provident Fund (NPF) established in 1961 was the first legislation enacted on Pension matters to cover private sector employees. In the opinion of Ikeji (2002), the colonial pension law was primarily designed for the British officials who moved from place to place within the vast British Empire and the intention was to guarantee continuity of service wherever they had worked. Ikeji (2002) notes further that the Pension Ordinance had limited application to Nigerian or indigenous employees and was granted at the pleasure of the Governor General. By implication, the pension Scheme at this period was not an automatic right of Nigerians who were discriminated against and were not sharing equal rights with the British officials. In equal vein, Orifowomo (2006) posits that Nigeria inherited a non-contributory and unfunded pension plan enshrined in Cap.30 of the Laws of the Federation of Nigeria which was solely designed to take care of colonial administration employees.

Pension Scheme has increasingly attracted the attention of policy makers in many countries as a means of facilitating privately funded retirement income savings by an ageing workforce (World Bank, 2009). Armstrong (2010) affirms that pension help employees to readjust themselves properly into the society. Chilekezi (2005) also notes that pension payment was channeled through budgetary allocations for each fiscal year and that the private sector seems better organized than the public sector. In the opinion of Stems (2006) pensions could discourage labour turnover since both employers and employees contribute to the scheme which serves as a vehicle of joint interest and co-operation that could promote healthier labour relations. In choosing a model of pension suitable for the Nigerian environment, Dostal and Cassey (2007) argue that the Nigerian government perceived the Chilean pension as a model to be copied but failed to realize that at the period of adopting the Chilean model, Chile was already preparing for an alternative Social Pension Scheme due to criticisms from her citizens, other stakeholders and the World Bank. According to some stakeholders the Chilean model did not meet the expectations it was set out to achieve due to some spurious assumptions. Consequently, the stakeholders were of the view that for the Scheme to realize its objectives in Nigeria, reform measures should complement or precede the pension reforms (Gill, Packard & Yermo, 2005; Holz & Hinz, 2005; World Bank, 2005).

Pension as a system for providing financial security for the old seems to be under increasing strain especially in developing country like Nigeria. Most of the employees neither have any meaningful retirement benefits nor earn enough during their working life to cater for their retirement. The extended families and other traditional ways of supporting the old are already weakening under the pressure of urbanization, industrialization and increased mobility. Consequently, the administration of the pension scheme was weak, inefficient and non-transparent (Kunle & Iyefu, 2004; Taiwo, 2006). Toye (2006) adds that there was no authentic database for pensioners and several documents were required to file pension claims. Gbitse (2006) observes that the Scheme in the public sector became unsustainable and was further compounded by increase in salaries and pension payments. In addition, Gbitse (2006) adds that the Pension Fund Administrators were largely weak, inefficient and lacked transparency in their activities. Added to these was poor supervision of Pension Fund Administrators, ineffective collection, management and disbursement of pension funds. Commenting on the old Scheme, Toye (2006) alludes the problem to poor records management and documentation process by Pension Board as well as the inability of Pension Fund Administrators to effectively carryout their duties in line with the provisions of the Pension Reform Act.

Managing and administering pension funds have continued to pose a major challenge to government in Nigeria. Yet pension which guarantees an employee certain comfort in his or her inactive year is critical to the sustenance of the life of individual and the society (Nkanga, 2005). Frankly speaking, the current contributory pension regime was intended to bring certainty, confidence and accountability to pension system in Nigeria as the erstwhile system was characterized by endemic fraud and corruption which in turn inflicted severe pains and misery on retirees who offered several years of meritorious services to the nation and their fatherland. It was observed that prior to the establishment of the new pension scheme on 1st July, 2004, the Federal Government had accumulated about N2trillion unfulfilled obligations to its former employees some of whom died out of frustration (Adeniyi, 2006). It is also very worrisome that the objectives of the Pension Reform Act, 2004 has been largely compromised as looting of pension funds by fraudulent officials have continued unabated. The National President of Trade Union Congress of Nigeria, Comrade Bobboi Kaigama lamented on the helplessness of government to arrest the rot but warned that:

*"Nigerian workers would no longer tolerate a scenario where any individual, corporate outfit or even government will dip hands in the pension fund under the guise of borrowing" (Dada, 2014).*

In the old system of pension scheme earning were made to appreciate or increase with raises in the salaries of serving workers. It is suggested that the new Scheme should incorporate safety net that makes provision for shortfalls in investment expectations. This contingency has become imperative due to the present global economic downturn and continuous deteriorating operations of the Nigeria Stock Market (Atedo, 2008). According to Fapohunda (2013), the new Pension System vividly excludes workers in the informal sector though the study agreed that integrating workers in the informal sector into the new Scheme would be difficult and herculean task. Therefore, Fapohunda (2013) suggests an all-encompassing need to address the effective participation of the informal sector in the new Scheme. There is no gainsaying the fact that in the current decade individuals at old age must face the reality of looking after themselves rather than relying on family and also build an egg nest for their wellbeing and future survival. Conclusively, an objective appraisal of the new Scheme since a decade of its existence has not indicated a convincing evidence that the Scheme is leading the country in the right direction nor is it bound to succeed.

## 3. Pension Fund Operators

The operators provided by the Pension Reform Act for the Scheme are Pension Fund Administrators (PFAs) and Pension Fund Custodians (PFCs). A PFA is a company licensed by PENCOM (the Pension Commission) to manage and invest the pension funds in the RSA of an employee. The PFA opens and administers RSA (Retirement Savings Account) for every employee in liaison with PENCOM and appoints PFC of its choice. The PFA also provides customer support services including account balances and payment of retirement benefits; while a PFC is a company licensed by PENCOM to keep pension money and assets in the RSA on trust for the employee on behalf of the PFA. The PFC receives the total contributions from the employer and informs the PFA within 24 hours on receipt of the value. It also executes transactions and undertakes other related activities on behalf of the PFA. The contributors are the employers and the employees. The employer deducts at source the monthly contribution, not later than seven (7) working days from the date the employee is paid his salary, and remits an amount comprising the employee's and employer's contribution to the custodian specified by the PFA of the employee and notifies the PFA. The PFA, on receiving the notice, credits the RSA of the employee for whom the employer had made the payment.

The employee, on his part, shall open a RSA with any PFA of his choice and notifies his employer of the PFA chosen and the identity of the RSA; i.e. the Personal Identification Number (PIN), the Pension Fund Custodian of the PFA etc. An employee can transfer his RSA from one PFA to another without giving any reason for doing so, provided that it is done only once in a year. With the use of password, access code and Personal Identification Number (PIN) allocated to him, the employee can monitor his RSA to ensure that it is correctly credited and at the appropriate time. If the employee changes employment, he simply notifies his new employer of the details of the PFA that manages his RSA and thereafter the new employer will send his contributions to the Pension Fund Custodian (PFC) of the Pension Fund Administrator (PFA). As a form of checks and balances, the Scheme entrenches the principles of transparency and accountability. This is reflected in the requirement of the PFAs and PFCs to provide regular information on investment returns to both the contributor and PENCOM. An employee has the right to receive statements of his/her account on quarterly basis with details of contributions made as well as returns on the investment of his/her fund. There is also imposition of penalties and sanctions on defaulters.

## 4. Grey Areas of the Scheme

The new pension scheme is mandatory for all categories of employers and employees covered under the Pension Reform Act. However, the Act exempts some category of persons from the scheme. This category is made up of the following; existing pensioners, employees who were entitled to retirement benefits before 1st July, 2004 and who had three (3) years or less to retire and those covered by the provisions of Section 291 of the 1999 Constitution of the Federal Republic of Nigeria - these are Judicial Officers appointed to the Supreme Court or Court of Appeal (Pension Reform Act, 2004). The 'National Pension Commission shall compute previous deductions made from staff salaries of the above category of employees before the coming in place of PFAs and PFCs. The sum computed shall be transferred to the employees' respective RSAs. Thereafter, subsequent deductions shall be forwarded to their PFAs through their PFCs.

Employee's access to his RSA will only be allowed upon retirement. If an employee retires at the age of 50 years or more he can have immediate access to the RSA. Similarly, if he retires before the age of 50 years he can have immediate access to his RSA on the condition that the retirement is due to mental or physical incapacity. But if the retirement is in accordance with the terms and conditions of employment he will not access his RSA until after six (6) months of such retirement if he does not secure another employment. However, where an employee makes additional or voluntary contribution into the RSA, he can withdraw such money before retirement or attainment of the age of 50 years. When an employee retires, he can withdraw a lump sum from the balance in his RSA provided that the balance after the withdrawal could provide an *annuity* or fund monthly payments that would not be less than 50% of his monthly remuneration as at the date of his retirement. An *annuity* is an income purchased from an approved life insurance company, which provides monthly or quarterly income to the retiree during his lifetime. The balance in the RSA, after withdrawal of the lump sum, will be used to procure an annuity that provides regular income to the contributor or fund a *programmed withdrawal.* A programmed withdrawal is a method by which the employee collects his retirement benefits in periodic sums spread throughout the length of an estimated life span.

Contributions made into the National Social Insurance Trust Fund (NSITF) which operates as a pension scheme for private sector employees before the commencement of the new pension scheme shall remain with the NSITF for a minimum period of five (5) years from the take off date of the new scheme. NSITF shall establish a company to be licensed by PENCOM as a PFA, which will manage the funds (Pension Reform Act, 2004). A Federal Government Retirement Bond shall be issued to an employee in acknowledgement of his accrued retirement benefits for the previous years he has been in employment before the new scheme commenced. This is applicable to employees of the public service of the Federation and the Federal Capital Territory, where pension scheme was unfunded. The bond shall be redeemable upon retirement of the employee (Pension Reform Act, 2004). The Federal Government of Nigeria had established a Retirement Benefits Bond Redemption Fund Account in the Central Bank of Nigeria. The government is already making a monthly payment into the fund of an amount equal to 5% of the total monthly wage bill payable to all employees in the service of the Federal Government and the FCT. In the case of funded pension schemes in the Public Service of the Federation and the Private Sector, employers shall undertake *actuarial valuation* of their employees' accrued benefits and credit the RSAs of employees with such funds (Pension Reform Act, 2004). An actuarial valuation here means a valuation or calculation made taking cognizance of risks or expected life span of the employee.

## 5. The Pitfalls of Pension Reform Act, 2004

A critical examination of the Act revealed the underlisted defects which are not fundamental or substantial to compromise or undermine the overall objectives of the Act:

**a. None Coverage of Some Categories of Workers:**
The scheme did not cover State government and Local Government employees.

**b. Discriminatory Nature and Rate of Contribution:**
Public and private sector employers and employees pay seven and half percent of their salary as pension contribution while Military personnel pay two and half percent of their salary and Federal Government pays twelve and half percent on their behalf. This negates the 1999 Constitution on the principle of equality. Besides, the Act exempts employees who at the commencement of the Act are entitled to retirement benefits in the existing scheme before this Act but has three or less year to retire and also judicial officers.

**c. Abolition of Gratuity Right:**
In the past dispensation, a gratuity is a lump sum payment while pension is a periodic payment, normally on monthly basis for the remaining part of the pensioners' life. The present Act abolished the right to a gratuity thus denying the employee the chance of lump sum payment to take care of cogent and immediate needs.

**d. Delay in Payment of Retirement Benefits:**
The intention of the Act is to remove or reduce past bottlenecks and hardships associated with payment of pension benefits but the present arrangements seem to have heightened delays in the payment of retirement benefits. The law provides that employee who retires before 50 years on request can withdraw 25% lump sum to his credit in the RSA but the withdrawal can only be made 6 months after retirement and such a person should not have secured another employment. Suppose the employee dies before the expiration of the six months? He is thus denied the enjoyment of benefit from his personal savings.

**e. Non Remittance of Deducted Contributions by Employers:**
The Act stipulates a penalty of 2% total contributions by an employer for non-remittance or delay in remittance of contributions to Pension Fund Custodians (PFC). The penalty seems not to be strictly enforced by PENCOM. Besides, some employers prefer to hide in the canopy of non-remittance of deducted funds rather than sourcing for funds from Banks which is costly.

**f. Returns from Investment of Pension Fund and Assets:**
The Act empowers the PFC to invest the pension funds but it did not state how workers can benefit from the accruals of the returns on the investment and assets emanating from their contributions.

**g. Ambiguity in the Definition of Minimum Retirement Age:**
Public sector statutory retirement age varies between 55 and 60 years. But the Pension Act did not stipulate any specific provision on this matter rather it stipulates that no person shall be entitled to make any withdrawal from Retirement Savings Account (RSA) before attaining the age of 50 years.

**h. Management Structure of the Pension Fund:**
The Act provides for PENCOM which is dominated by government representatives. The Nigeria Labour Congress and Nigeria Union of Pensioners are also represented. However, the Trade Union Congress and other unions in various industries who are important stakeholders are left out in the Act.

**i. Pension Fraud and Corruption:**
There are many reported cases of fraudulent acts associated with pension schemes. The schemes are infested with corruption and blossoming thievery of pension funds by those entrusted with the management of the schemes and there seems to be no serious measures in place to tackle the monster.

**j. Care of Retirees Versus Interest of Investors:**
The real aim of the pension scheme is to provide employee post-employment benefit and welfare. The scheme in its operation seems to have provided a pool of funds for investors rather than concern for the livelihood

and welfare of employees at old age.

**k. The Retirement Age Controversy:**

The Act stipulates that a holder of RSA upon retirement or attaining the age of 50 years shall utilize the balance standing to the credit in his RSA for a programmed monthly or quarterly withdrawal on the basis of an expected life span. How will the expected lifespan of individuals be determined? Does senior and junior staff have same average lifespan? What criteria will be used in calculating the expected lifespan of individuals? What happens if actual lifespan is shorter than the calculated lifespan? Who enjoys the surplus? What happens if the actual lifespan of the estimated expected lifespan of the retiree is longer than estimated expected lifespan? Who supplies the shortfall to maintain the retiree for the rest of his or her life? These are posers to be addressed.

**l. Denial of Access to Court:**

A dissatisfied retiree or beneficiary cannot go to court but he is expected to apply to PENCOM to review the matter in an accelerated manner with a view to speedy resolution. If any of the party is not satisfied with the decision of PENCOM, it may take the case to Arbitration or Investment and Security Tribunal. This contravenes the provision in the 1999 Constitution which guarantees access to court. Section 6 subsection (6) of the 1999 constitution guarantees access to court. This portrays double standard in rule making and need to be addressed.

## 6. Conclusion

Following public outcry on the need for amendments to the Pension Reform Act, the Federal Government of Nigeria in April, 2013 forwarded an executive bill to the National Assembly to review some aspects of the Pension Reform Act, 2004. The highlights include:

i. The need to enhance the powers of the National Pension Commission (PENCOM) in its regulatory and enforcement functions.
ii. To tighten the nuts and bolts in protection of pension fund and assets.
iii. To unlock the opportunities for development of pension assets for national development.
iv. To review the sanctions regime to reflect current economic realities.
v. To provide for the participation of the informal sector.

Conclusively, there is need to review the Pension Reform Act. For the Pension Reform Act to exhibit sincere intention, government and the private sector employers should from time to time pay workers enhanced living wages and salaries which will pull them out of poverty line and make it convenient for them to contribute their share to the scheme with ease. By every measure, a thorough and critical analysis of the Pension Reform Act call for an urgent review of some portions of the Act to check poverty, misery, fraud, corruption, abuses and enhance living standard of the masses especially the working class. To treat these observations or findings with levity or same swept under the carpet may be tantamount to compromising the future of the Nigerian workers.

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